FACT SHEET
FILM PRODUCTION GUARANTEE PROGRAM

The Export-Import Bank of the United States (Ex-Im Bank), an independent agency of the Federal Government, is announcing a new and innovative program to support the independent film industry.

Who are the independents? The film industry is divided between recognized major studios and the independent sector. Whereas major studios are multinational, mass marketing, corporate groups, which own their distribution channels around the world, the independent sector consists of individually financed projects with ownership retained by the producers, who license the film rights to independent distributors throughout the world. The major studios are represented by the Motion Picture Association of America (MPAA) while the independent sector is represented by the American Film Marketing Association (AFMA).

How do independent films get financed? Unlike major studios, independent film producers rely heavily on bank financing. Bank production loans are typically secured by distribution contracts that require unconditional payment by distributors when the film is made available. These contracts are usually with foreign distributors (also known as licensees) who are purchasing the film rights for their countries. Independent producers may also conclude contracts for the U.S. market, but U.S. distributors, who have superior bargaining power, generally will not make up-front commitments to a film. Consequently, the initial collateral available to secure a loan commitment consists solely of foreign distribution contracts.

The producer usually creates a paper corporation for each film project, with no assets outside of contributions made by the producer or investors. Thus, the only source of loan repayment will be amounts received from distribution contracts. Lenders do not bear performance risk, such as cost overruns or replacement of key talent, since they will contract with a specialized guarantor to ensure completion of the film. The lender is primarily concerned that there will be sufficient contracts to cover the loan (marketing risk) and that the distributors make payment when the film is completed (credit risk).

Why should Ex-Im Bank support Indies? Support for the financing of independent film production is a natural fit for Ex-Im Bank's objectives and products. Ex-Im Bank's mission is to support U.S. jobs by fostering U.S. exports through loans, guarantees and export credit insurance. Not only does the independent sector rely on foreign sales to finance production, it generates significant employment. According to a report by Arthur Andersen Economic Consulting (*The Economic Consequences of Independent Film Making*), the independent film industry directly creates more than 148,000 U.S. jobs with a $2.5 billion payroll. According to a survey conducted by KPMG Peat Marwick, AFMA member companies generated over $2.3 billion in foreign sales in 1998 (of which sales by U.S. members of AFMA totaled $1.6 billion).

Production financing for independents is constrained by lenders' unwillingness to assume (or inability to evaluate) foreign credit and political risks. By creating a product that mitigates these risks, Ex-Im Bank can make a difference in individual loan decisions while helping to expand overall lending capacity for this important sector of the U.S. economy.

Independent film production is also being lured to foreign locations by government economic incentives. While Ex-Im Bank cannot directly counter these incentives, it can provide a product that reduces their appeal.

What is the Film Production Guarantee Program?

Ex-Im Bank will support the independent film sector by providing lenders a **Film Production Guarantee** as an incentive to make more film production loans. This conditional Guarantee can cover up to 90% of the loan amount, thereby limiting a lender's maximum loss to as little as 10%. In cases where the loan amount is not fully supported by the collateral, Guarantee coverage will be less than 90% (see next section).

The Program will *not directly* guarantee or insure all of the individual distribution contracts that make up the collateral for the loan. However, if defaults by foreign distributors cause a default on the loan, then a claim may be made under the Guarantee.

Does the Guarantee restrict a lender's use of "Gap" Financing?

Lenders often commit to a loan even though the collateral value (i.e., the distribution contracts) is less than the loan amount. This decision to provide "gap financing" depends on the lender's assessment of the likelihood that enough contracts will be concluded for currently unsold territories to fill the gap. In essence, the lender is assuming marketing risk.

While unrestrained use of gap financing has resulted in significant losses for some lenders, many successful films would never have been produced without this technique. While Ex-Im Bank does not assume marketing risk, it recognizes the value of prudent gap finance. Consequently, the Film Production Guarantee Program will not restrict the use of gap finance, but will limit Guarantee coverage to the non-gap portion of the loan.

Thus, Ex-Im Bank's maximum liability at any point in time will be 90% of the fully collateralized portion of the loan. This portion may increase (and the gap reduced) as more contracts are concluded prior to the loan due date. Any losses on the loan would first be for the lender's own account to the extent of any remaining gap. The lender could file a claim for 90% of all losses exceeding the gap. Ex-Im Bank would be entitled to 90% of all recoveries until any claims paid were fully recouped. Excess recoveries would be available to the lender for recoupment of any gap-related losses.

What are the Benefits of the Guarantee?

By providing 90% coverage of the collateralized portion of the loan, the Guarantee protects lenders against catastrophic default situations. While the Guarantee does not cover gap finance, the Program allows a more liberal valuation of collateral than generally used in the industry, which thereby decreases the gap.

In assessing collateral, lenders value contracts from *primary* distributors (those in large, developed countries) at face value while heavily (or even completely) discounting the value of contracts from *secondary* (i.e., non-primary) distributors. The Film Production Guarantee Program will follow industry practice with respect to primary distributors, while valuing contracts with "credit-worthy" *secondary* distributors with only a 35% discount. The smaller discount for these contracts will result in an increase in the collateral value and a decrease in the gap. This benefit should both: (1) influence lenders to commit to more loans on the margin and (2) increase overall capacity for film lending.

Who can apply for a Guarantee?

Although most of the Program benefits will accrue to independent film producers and employees in the entertainment industry, the direct beneficiaries will be lenders. Consequently, only lenders will be able to apply for a Guarantee. Since this Program will rely heavily on lender judgment, eligibility will be restricted to experienced lenders, defined as those whose management has extensive experience in film production lending secured by foreign pre-sale contracts.

What types of films will the Guarantee support?

In general, films must meet the following criteria:

Independent sector films. The Program is designed to support films produced by independent producers, financed by loans secured primarily by contracts with independent foreign distributors.

Primarily for export. Although the loan may benefit from domestic collateral, the majority of the collateral should relate to foreign distributors.

U.S. content. The majority of the production costs should relate to goods and services of U.S. origin. However, remuneration of foreign nationals will be treated as U.S. content if it is subject to U.S. income taxation.

Artistic content. The picture should have a rating from the Code and Rating Administration of the Motion Picture Association of America no more restrictive than "R".

What will the Guarantee cost and when will it be available?

There will be a flat Guarantee fee of 1% of the amount of the loan, without regard to term, which will be shared with the lender on a 50-50 basis. The Program is projected to be operational by May 2000.

An Example of How The Program Works

Filmlender wishes to apply for a Guarantee to support the production of Newfilm. Filmlender meets the eligibility criteria of participating lenders and executes a Master Guarantee Agreement with Ex-Im Bank, which provides a general format for administration of the Program. The production budget of Newfilm is $5 million, which includes all costs of filming, the completion guarantor fee, and financing costs (e.g., fees and interest reserves) charged by Filmlender. Newfilm is expected to receive an "R" rating and 80% of the loan amount is expected to relate to U.S.-related costs (including $1 million for the star actor who, although she has foreign citizenship, will pay U.S. taxes on remuneration from this film).

To produce the film, Filmproducer sets up a special corporation called Filmborrower, which will be the obligor for the loan. In addition to obtaining all of the intellectual property rights related to the film, Filmborrower signs up an experienced director and the star actor. Filmborrower also hires an experienced sales agent to pre-sell the film. Filmproducer and investors are willing to contribute $500,000 in equity to Filmborrower. The sales agent has also been successful in concluding pre-sale contracts for the film distribution rights in a half-dozen primary markets (e.g., Japan, Canada, Germany) as well as a number of contracts in secondary markets. These distributors made deposits totaling $500,000 with balances due upon film availability of $3 million for primary market distributors and $1 million for the other distributors.

Filmlender must decide on whether or not to commit to finance Newfilm. Filmlender values primary collateral at 100% but gives no value to non-primary collateral as follows:

Total amount needed:	$5,000,000
Less: equity invested	(500,000)
Less: deposits from distributors	(500,000)
Loan Amount Needed	$4,000,000
Primary contracts @ 100%	$3,000,000
Non-primary contracts @ 0%	0
Total collateral	$3,000,000
Gap financing necessary	**$1,000,000**

Filmlender decides to apply to Ex-Im Bank for a Film Production Guarantee. The Guarantee Fee is $4,000,000 x 1% = $40,000. According to credit information available (e.g., KPMG annual survey of payment experience and lender's own credit information), Ex-Im Bank determines that $615,000 of the non-primary distributors' contracts qualify for the *secondary collateral* classification. The remainder relates to distributors in countries where Ex-Im Bank does not offer short-term insurance on open account terms, or relate to distributors for which Ex-Im Bank and the lender could not find sufficient positive credit information. The new valuation of the collateral (and Ex-Im Bank's initial liability under the Guarantee) is as follows:

Primary contracts @ 100%	$3,000,000	
Secondary contracts @ 65%	400,000	(615,000 x .65)
Tertiary contracts @ 0%	0	
Total Collateral	**$3,400,000**	

The gap, compared to the initial loan amount, has been reduced by as much as $400,000. But the loan amount must be adjusted as follows: (1) it must be increased to include the 1% Guarantee Fee ($40,000), and (2) it must be decreased to reflect the lower gap finance fee. If Filmlender charges a flat 10% on the amount of the gap (plus interest), the original gap fee included in the loan amount was $1,000,000 x 10% = $100,000. The new gap is $400,000 less, so the gap fee will be reduced by $40,000. **The potential savings in reducing the gap (as a result of the Guarantee) are about equal to the cost of the Guarantee to Filmborrower (in this case)!** In this case, the loan amount will stay about the same.

> [NOTE: The lender may not necessarily adopt the Program methodology for valuing secondary collateral and measuring gap. A more conservative approach might take into account the fact that the Guarantee is for 90% of the fully collateralized value. This approach might value the secondary collateral, not at $400,000, but at 90% of $400,000 or $360,000.]

Now assume that Newfilm is produced, but that **no new contracts** are concluded. This means that the gap remains unfilled. The film negative is placed in bonded warehouses in the countries of the distributors and they are sent "Notice(s) of Film Availability", requiring them to pay the outstanding balances on their contracts. Most pay, but some default, either due to financial problems, or decisions that the film cannot be successfully marketed in their country. Even after 120 days have passed since the Notices of Availability, only $3 million has been collected on all contracts. This leaves a $1 million shortfall on the loan and Filmbank decides to make a claim under the Guarantee. Ex-Im Bank's Asset Management Division makes the following calculations of Ex-Im Bank's *actual* liability under the Guarantee:

Loan Amount:	$4,000,000
Amount fully collateralized	$3,400,000
Amount related to Gap financing	$ 600,000
Amount in default	$1,000,000
Less: amount related to Gap	(600,000)
Amount fully collateralized	$ 400,000
X 90% Guarantee cover	x .90
Claim Payment	**$ 360,000**

If, over the next six months, several of the defaulting contracts are either paid or the distribution rights resold to other, competing distributors in those markets, and total recoveries from these sources amount to $500,000, these recoveries would be allocated as follows:

Ex-Im Bank receives 90% of first $400,000 recovered	$360,000
Filmlender receives 10% of first $400,000 recovered	40,000
Filmlender receives all of excess over $400,000	100,000
Total Recoveries	**$500,000**

FREQUENTLY ASKED QUESTIONS

1. **Can a film be licensed to a major studio and still be eligible?** Yes, a film can benefit from a contract with a major studio for the U.S. distribution rights, or with a foreign arm of a major studio, for some of the foreign distribution rights, *so long as* the majority of the contract collateral relates to independent distributors.

2. **Will there be maximum amount of Guarantees available under the Program?** At this time, Ex-Im Bank does not envision any cap on total Program activity.

3. **Will there be a maximum amount for any specific lender?** At this time, Ex-Im Bank is not placing a cap on total lender activity under the Program.

4. **Will there be a minimum or maximum on the production loan amount?** No, although it is expected that most loans will be under $15 million. Loans above $15 million may get more scrutiny as to the need for U.S. Government support.

5. **What are the eligibility criteria for lenders using the Program?** The guidelines adopted for lender eligibility include: (1) the lender must have a specific division or company whose primary business is to finance motion picture and television production; and (2) Management of the division or company must have at least three years experience in lending against international contracts for independent feature film and/or television production. This experience should include at least 50 films where a minimum of 60% of the budget was covered with international pre-sale contracts, of which 20 such loans have been repaid. It may be possible for certain non-bank lenders to fulfill these eligibility criteria.

6. **How will contracts for U.S. distribution rights be handled?** These contracts will be treated as *primary* collateral for the loan and will increase the portion of the loan covered by the Guarantee (and reduce the "gap") by their full amount. The total amount of any U.S. distribution contract should be reasonably expected to be no more than 50% of the total loan amount in order for a film to be eligible (i.e., the majority of the loan should be expected to be repaid from foreign contracts).

7. **Will a completion guarantee be required?** The Program follows normal industry practice in requiring a completion guarantee as well as assignment of all intellectual property rights related to the film.

8. **Will there be any limit on the proportion of the loan that is financed by "gap" financing?** No, although any losses on the loan related to an "unfilled gap" amount are for the lender's own account. The guaranteed (i.e., fully collateralized) portion of the loan will be in a superior position vis-à-vis the portion related to "unfilled gap" with respect to any losses as well as any recoveries.

9. **Will all contract payments be used to recover any Ex-Im Bank claim payments?** Yes, all recoveries or recoupment, from any source (including any domestic contract or contracts which are fully discounted) will be used **first** to recover any claim payments made by Ex-Im Bank and thereafter to recoup any lender losses related to "unfilled gap". Recovery of claim

payments will be shared with the lender on a 90% (Ex-Im Bank) – 10% (lender) basis, since the Guarantee provides 90% coverage.

10. **Will the 1% Guarantee fee be charged on the entire loan amount, or just the amount that is "fully collateralized"?** The 1% fee will be charged up-front on the entire loan amount, regardless of the amount of "gap" financing provided. The fee is flat and will not depend upon the exact term of the loan, but will be shared with the lender on a 50-50 basis.

11. **Can foreign lenders participate in the Program? Can non-bank lenders participate?** Foreign lenders with an office and legal presence in the U.S. can apply to use the Program.

12. **Will the Program allow industry practices, such as extensions on loan maturity dates, to allow slippage in film schedules or to allow sales agents more time to "fill the gap"? What about the situation where a distributor fails to make a contractual downpayment, and the lender includes it in the balance due upon film availability rather than declaring a default?** Program documentation is expected to allow for flexibility in situations such as these.

13. **Does the borrower need to be a U.S. company?** Ex-Im Bank may allow a borrower to an offshore entity for purposes of deferring taxation.

14. **Will this Program delegated authority to lenders to commit the Guarantee? If not, what sort of turnaround time is projected for decision making?** This Program will not involve delegation of authority, but a relatively quick turnaround time is anticipated for Guarantee decisions on loan amounts of up to $15 million. Larger loans may involve a longer decision period due to a different approval process. On a case-by-case basis, Ex-Im Bank may allow backdating of Guarantee coverage of a loan that has already been committed, even if production has begun.

15. **Will the Program allow loan participations or co-financings?** Yes. However, the applicant lender must remain responsible for all lender obligations under the Program and Guarantee (e.g., filing of claims documentation).

16. **Lending banks typically enter into sales agency subordination agreements with sales agents, whereby a significant portion of sales agents' fees is subordinated to loan payoff. How will the Program treat these fees?** The Program will "piggyback" on arrangements agreed upon by the lender and sales agent(s).

17. **Are there any restrictions on how much of the filming is done outside of the U.S.?** So long as 50% of the costs of production relate to U.S. goods and services (and or the services of foreign nationals which are subject to U.S. taxation), there are no restrictions on the location of the actual filming.

18. **Will a borrower's film be eligible if the borrower will benefit from foreign government incentives, such as tax incentives and production credits? How will these be treated?** The U.S. Government is against foreign government economic incentives designed to lure the production of independent films from the United States to foreign countries. These incentives for "runaway production" may require, inter alia, that the production company be

domiciled in the foreign jurisdiction; that some minimum content or production budget spending take place in the foreign jurisdiction; and/or that the copyright be held by the foreign entity. While the Film Production Guarantee Program will not directly counter such incentives, it will provide one more argument for keeping production in the U.S. Ex-Im Bank has not yet decided on whether to rely solely on the 50% U.S. content requirement to support U.S. benefits related to independent film production, or whether to also deny eligibility of any film borrower which will take advantage of foreign production incentives.

19. **Will Ex-Im Bank guarantee a program of films?** Whereas a lender might commit in advance to financing a certain number of films to be made by a given producer, Ex-Im Bank will only provide Guarantees for single-film loans, where the film is about to enter the production phase.

20. **Does Ex-Im Bank envision public policy issues related to a judgment of excessive sex and violence in independent films?** To be eligible for the Program, a film must obtain a rating from the Code and Rating Administration of the Motion Picture Association of America no more restrictive than "R". Failure to obtain such a rating would render the Guarantee null and void.

21. **Will non-payment by distributors due to disputes with producers or other non-financial reasons be covered by the Guarantee?** The Guarantee extends only to the collateralized portion of the <u>loan</u>, it does not guarantee payment on individual distribution contracts. However, if defaults by distributors <u>for any reason</u> have the effect of causing a default on borrower repayment of the loan, the guarantee will cover such losses (provided that losses are first borne by the lender to the extent of any "unfilled gap" and are only thereafter covered by the Guarantee.)

22. **How will the "fully collateralized" portion of the loan and the "unfilled gap" portion of the loan be measured? When will it be determined? By whom?** These questions relate to key Program features of measuring the value of the collateral. The value of the collateral will initially be determined at the time that the Guarantee of the loan is approved. The value of "unfilled gap" is merely the residual value found by subtracting the (discounted) collateral value from the total loan amount.

    The value of the collateral may be subject to increase throughout the life of the loan each time a new distribution contract is executed. Any increase in the (discounted) value of the collateral represents an increase in the amount of the loan, which is covered by the Guarantee (and a decrease in the "unfilled" gap). The changing value of the collateral will be determined by Ex-Im Bank in accordance with periodic *Collateral Base Certificates* submitted by the lender, which provide an updated list of the contracts. Ex-Im Bank will classify these contracts as:

    primary which are included at face value;

    secondary, which are included at 65% of face value (i.e., a 35% discount); or

    tertiary, which are given no value (i.e., fully discounted).

23. **How will primary collateral be classified?** Ex-Im Bank will follow lender practice as much as possible in classifying contracts with distributors in a list of developed countries as *primary collateral* which would be valued at face value. Some distributors from countries outside of the "primary" list may be given primary status, based on exceptional credit information. Ex-Im Bank will classify all contracts from the same distributor consistently with respect to different film projects.

24. **How will secondary and tertiary collateral be distinguished?** In general, all contracts with non-primary country distributors will be classified either as secondary or tertiary collateral. Secondary collateral will be valued at 65% of face value and tertiary collateral will have no value. Generally speaking, for contracts to be classified as secondary, there must be favorable credit information on that distributor. Where the credit information on a distributor is negative, unavailable or insufficient, the contracts related to that distributor will be classified as tertiary. Furthermore, all contracts related to distributors located in countries where Ex-Im Bank is not open for short-term credit transactions on open account (as per Ex-Im Bank's published *Country Limitation Schedule*) will automatically be classified as tertiary.

25. **What if a lender disagrees with the classification of some of the collateral?** Ex-Im Bank will try to follow lender classifications to the extent practicable, and will develop credit guidelines for secondary collateral classifications, which will give weight to lender experience and credit research. Due to its central position in being privy to credit information on certain distributors from several lenders, Ex-Im Bank may sometimes know of favorable or unfavorable credit information that might dictate a different classification of a foreign distributor from that recommended by the lender. Overall, Ex-Im Bank hopes to promote better decisions through the centralized collection of credit information on foreign distributors from a number of sources.

MORE INFORMATION

Headquarters

Internet	http://www.exim.gov
U.S. Toll Free Number	(800) 565-EXIM
Worldwide Number	(202) 565-3946
Business Development	(202) 565-3900 Fax (202) 565-3931
TDD	(202) 565-3377
Fax Retrieval	(800) 565-EXIM, press 1, press 2
E-Mail	bdd@exim.gov
Order User's Guide	(800) 565-EXIM, ext. 3912
Seminars	(800) 565-EXIM, ext. 3912

Regional Offices

Northeast - New York	(212) 466-2950	Fax (212) 466-2959
Mid-Atlantic - Washington, DC	(202) 565-3940	Fax (202) 565-3932
Southeast - Miami	(305) 526-7425	Fax (305) 526-7435
Midwest - Chicago	(312) 353-8081	Fax (312) 353-8098
Southwest - Houston	(281) 721-0465	Fax (281) 679-0156
West - Long Beach	(562) 980-4580	Fax (562) 980-4590
Satellite - San Jose, CA	(408) 271-7300 ext. 104	Fax (408) 271-7307
Satellite - Orange County, CA	(949) 660-1688 ext. 150	Fax (949) 660-8039